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# GAIN Report

Global Agricultural Information Network

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## **New Zealand**

### **Dairy and Products Semi-annual**

### **Milk Production and Dairy Products Report**

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**Report Highlights:**

New Zealand Milk Supply is on track for record production in 2011 at 18.05m tons and dairy farmers are welcoming the forecast of the second highest payout ever for the milk supplied during the 2010/2011 NZ production season. A record 948,000T of WMP was exported in 2010 with exports of WMP to China jumping 72% from 2009.

## **Executive Summary**

There is renewed optimism in the New Zealand dairy industry. International dairy product prices are high and the domestic farm gate milk payout price for the 2010/11 season is set to be the second highest on record. (The record was set during the 2007/08 season.) Fonterra, the farmer-owned cooperative that processes approximately 89% of the nation's milk supply, is forecasting a payout of NZ\$7.75/kg milk solids. The milk supply estimate for calendar year 2010 has been revised upward slightly to 17.2 million tons. Milk supply for calendar year 2011 is forecast to reach a record 18.05 million tons, a 1.2% increase over 2010.

Total production in calendar year 2010 of the four main dairy commodities - whole milk powder (WMP), skim milk powder (SMP), cheese and butter/anhydrous milk fat (AMF) - is estimated at 2 million tons, 60,000 tons higher than the previous estimate. While the total production forecast for 2011 remains unchanged at 2.114 million tons, the estimate for WMP production has been revised upward by 13%. WMP tends to be more profitable than other dairy commodities and, reflecting this, nearly all of the processing capacity built over the last decade in New Zealand has been powder driers. Dehydrating is still the least cost way to process liquid milk into a more non-perishable form, which is important given New Zealand's isolation and distance from markets.

Exports are forecast to reach a record 2.4 million tons in calendar year 2011. Accounting for over a quarter of New Zealand's total export receipts, dairy exports are critically important to New Zealand's economy. While WMP exports are forecast to reach 990,000 tons, up from 948,000 tons in calendar year 2010, cheese exports are predicted to fall to 237,000 tons, down from 268,000 tons in calendar year 2010.

China continues to be New Zealand's top market for dairy exports, accounting for 17.4% in calendar year 2010, up from 12.2% the previous year. Leading dairy product exports to the Chinese market are WMP, SMP, and butter/AMF. New Zealand exports of WMP to the Chinese market jumped 72% in calendar year 2010 to 294,181 tons.

Global Dairy Trade, Fonterra's auction platform, continues to gain ground. Nearly a quarter of total exports, or 544,150 tons, were sold through the auction system in 2010. This compares to 10% of total exports, or 228,700 tons in 2009. WMP, SMP, and AMF make up the bulk of commodities sold on the platform.

Rising retail milk prices have led to public and industry calls for an independent regulator of domestic milk prices. The New Zealand Commerce Commission has announced that it will conduct a preliminary investigation into the domestic milk market to determine if a full price inquiry is warranted. The Commission's report is expected in the next couple of months.

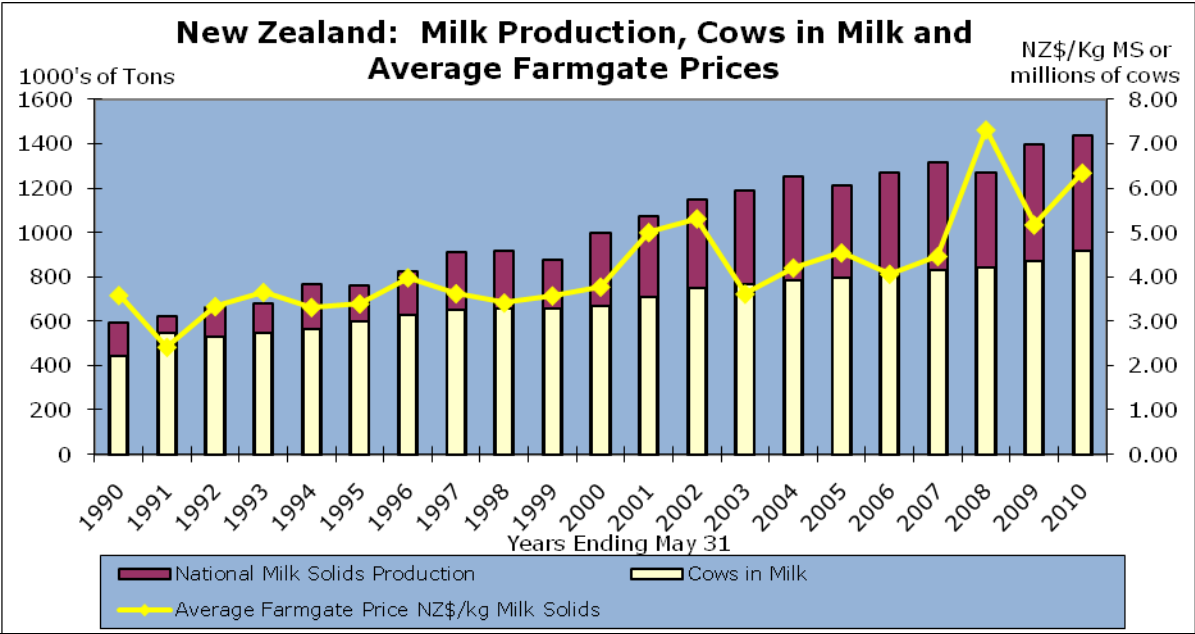
In spite of overwhelming farmer support, some speculate that election year hurdles could delay implementation of Fonterra's "Trade Amongst Farmers" (TAF). TAF would require farmers exiting the cooperative to find buyers for their shares rather than relying on Fonterra to redeem them. Fonterra competitors have expressed concern that TAF will lack sufficient liquidity, thereby preventing farmers from exiting Fonterra to supply competitors.

*Note: As of 2010, all PSD tables are calculated on the basis of calendar year data. The marketing year (MY) is now the same as the calendar year.*

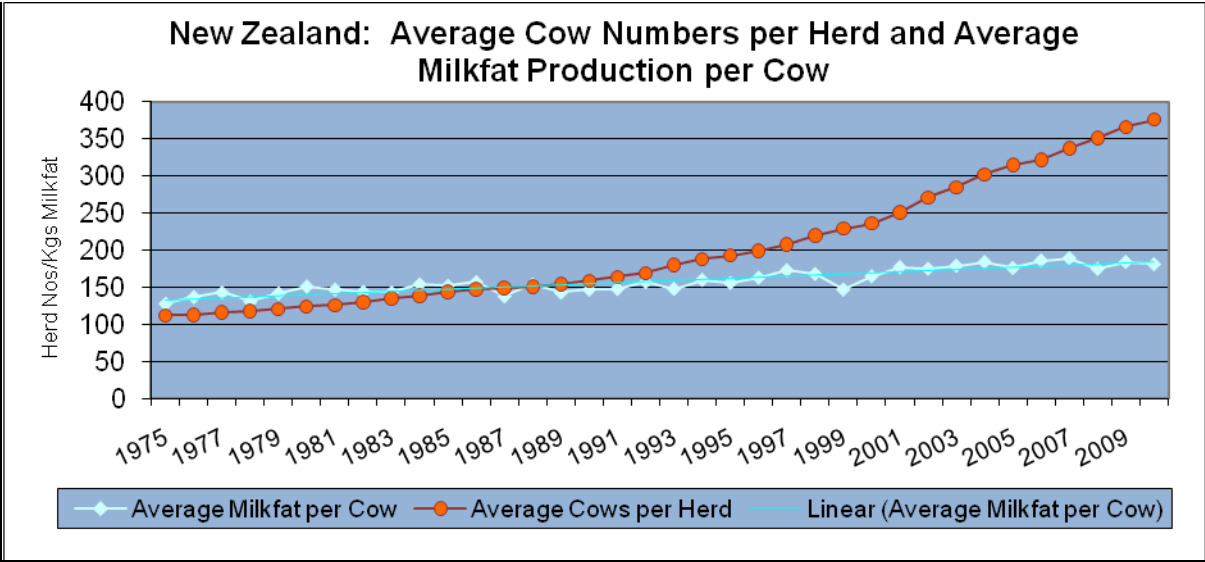
## **Production**

### **Milk Supply MY2010 (Jan 2010 to Dec 2010)**

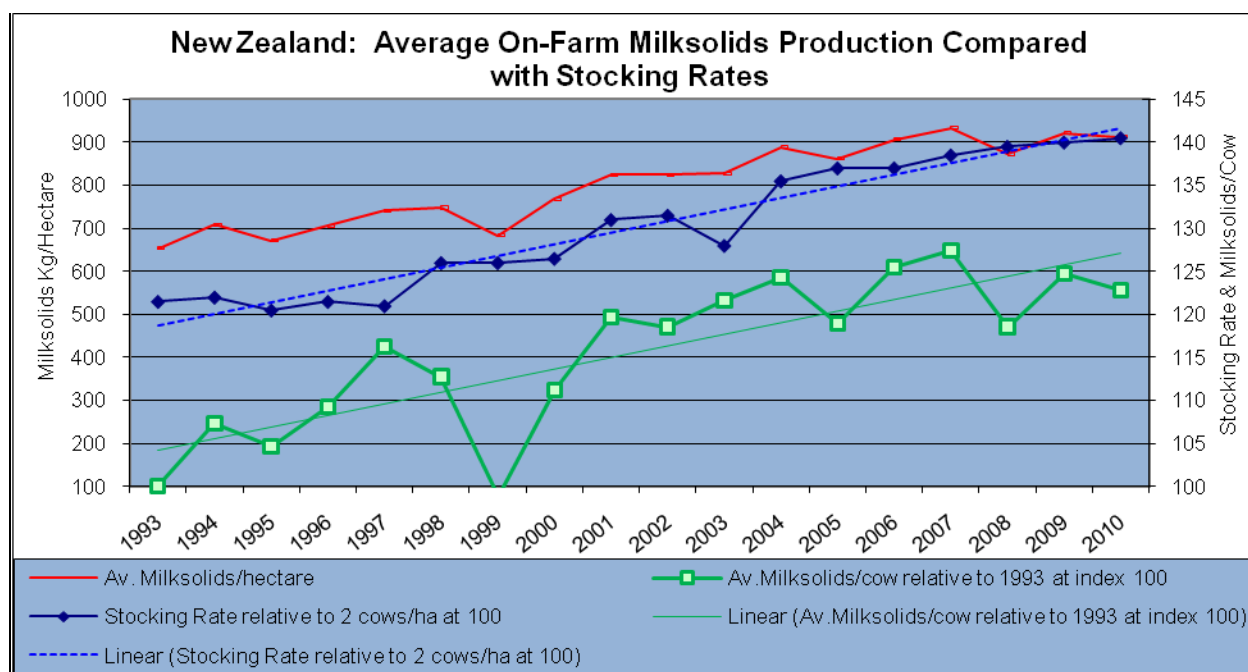
Although a severe September storm disrupted production, particularly in Southland and Otago, production during the second half of the year was slightly ahead (0.72%) of the same period last year with higher milk flows being recorded in four of the six months during the second half of the year. Reflecting this, the milk production estimate has been revised upward by 1.6% to 17.2 million tons.



Sources: Livestock Improvement Corporation (LIC), DairyNZ, StatsNZ, Ministry of Agriculture and Forestry (MAF)



Sources: Livestock Improvement Corporation (LIC), Dairy NZ, MAF, Stats NZ



Sources: LIC, DairyNZ, StatsNZ, MAF

New Zealand: Profitability of Dairy Farming (NZ Dollars per kilogram of milk solids)						
Key Indicator Category	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11 Forecast
Milk Sales	4.13	4.12	7.35	5.20	6.16	7.39
Livestock Sales & Sundry Income	0.21	0.31	0.45	0.45	0.37	0.40
Change in Value Livestock	0.24	0.16	0.15	0.02	-0.01	0.05
<b>Total Gross Income</b>	<b>4.58</b>	<b>4.59</b>	<b>7.95</b>	<b>5.67</b>	<b>6.52</b>	<b>7.84</b>
Farm Working Expenses	3.54	3.63	4.91	4.88	4.51	4.80
<b>Operating Profit</b>	<b>1.04</b>	<b>0.96</b>	<b>3.04</b>	<b>0.79</b>	<b>2.01</b>	<b>3.04</b>
Debt Servicing	0.98	1.01	1.30	1.58	1.51	1.40
Rent	0.10	0.10	0.09	0.12	0.15	0.15
<b>Net Profit</b>	<b>-0.04</b>	<b>-0.15</b>	<b>1.65</b>	<b>-0.91</b>	<b>0.35</b>	<b>1.49</b>

Source: DairyNZ

## Milk Supply MY2011 (Jan 2011 to Dec 2011)

The milk production forecast has been revised downward by 3.2% to 18.05 million tons, which is still a 5% increase over 2010. The current forecast is based on the following factors:

- The actual increase in cow numbers is not as high as originally expected and has been revised downward by 50,000 head to 4.8 million
- The La Nina weather pattern, which tends to bring warm dry weather to New Zealand, threatened drought-like conditions in some regions of the country. However, rainfall levels have been relatively good throughout the country in 2011
- Nationwide, milk production for the 2010/11 season to mid-April was running nearly 2.5% ahead of last year
- Current cow condition and pasture levels bode well for production during the second half of 2011
- Some districts affected by drought in 2010 recorded daily milk flows in April 2011 between 50% to 100% higher than last year

- Levels of feed supplements on hand for winter and spring feeding (to top up pasture deficits) are reportedly good in the South Island, low in the Central Districts North Island, and tight in the Waikato
- Waikato farmers are reportedly planning to use imported palm kernel and cereal grains to top up supplement levels on an as-needed basis
- Increasing quantities of feed wheat are reportedly being imported from Australia
- Approximately 125 new dairy farms are due to begin production in August 2011, bringing an estimated 100,000 extra cows to milk

Some sources report that, given the generally improved condition of New Zealand dairy farms, some of the latent production potential pent up by poor pasture growth in the past three seasons could be realized in the 2011/12 season. Anecdotally, at this stage, there are more cows than average that are not in calf, which could have a negative impact on production next season.

## Prices

Fonterra is forecasting a milk price for the year of NZ \$7.50/kg and distributable profits of 40-50 cents a share. However, the cooperative plans to retain between 15-20 cents a share, leaving a dividend of around 25-30 cents which would mean a final payout to the farmer shareholders of NZ\$7.75/kg Milk solids.

Westland announced a final payout forecast range of NZ \$7.40 to \$7.60 per kilogram of milk solids and said it was unlikely to beat its 2008 payout record of \$8.29, before retentions.

Payout Prices by NZ Dairy Cooperatives			
(Per Kg of Milk Solids)			
Company Name	Payout 2008/09	Payout 2009/10	Payout Forecast 2010/11
Fonterra	NZ \$5.20	NZ \$6.37	NZ\$7.75
Tatua	NZ \$5.38	NZ \$6.32	NZ\$7.50-8.00
Westland	NZ \$4.50	NZ \$6.15	NZ\$7.50

Sources: Tatua, Westland, Fonterra, Dairy Exporter Magazine

Note: Payout includes raw milk price and dividend payout.

## **Commodity Production**

Total production in 2010 of the main four commodities (WMP, SMP, Cheese and Butter/AMF) is estimated at 2 million tons, which is 60,000 tons higher than the previous estimate. The 2011 forecast remains unchanged at 2.114 million tons. *(Note that all fat production is converted to a butter equivalent.)*

### **Whole Milk Powder (WMP)**

#### **MY2010**

Production is estimated at 947,000 tons, a 14% increase over the previous forecast. This translates into an annual growth rate of 23%, which is significantly higher than the long term trend of 6.5% to 7% p.a. Ending stocks are forecast at 100,000 tons, which is 67% higher than the previous forecast. The increase in WMP production will drive an increase in exports.

#### **MY2011**

Production is forecast to expand further reaching 1,015,000 tons, which is 13% higher than the previous forecast. The increase reflects the expected increase in milk supply during 2011, which will largely be used to produce WMP. WMP tends to be more profitable than other commodities and, reflecting this, nearly all the processing capacity built over the last decade in New Zealand has been powder driers. Dehydrating is still the least cost way to process liquid milk into a more non-perishable form, which is important given New Zealand's isolation and distance from markets.

### **Butter and Anhydrous Milkfat (AMF)**

#### **MY2010**

Butter production is estimated at 441,000 tons, 2.7% less than the previous forecast and down 8.5% from the previous year. Relative export pricing has historically favored protein production over fat production. However, the picture changed in 2008 and 2009, when butter and fat production increased.

#### **MY2011**

The production forecast has been revised downward by 9% to 454,000 tons. During early 2011, the price of AMF increased significantly in Fonterra's Global Dairy Trade auctions favoring the production of a combination of AMF/SMP over WMP. The AMF price has fallen since mid-March which suggests that WMP will be favored over AMF/SMP, but industry views differ on how the relative pricing will drive production decisions.

### **Skim Milk Powder**

#### **MY2010**

SMP production is estimated at 344,000 tons, a downward revision of 3%. This is a consequence of the decline in butter/AMF production. (In most manufacturing situations, SMP is a co-product of butter or AMF production.)

#### **MY2011**

In line with flat butter/AMF production forecasts, SMP production is revised downward by 6.3% to 375,000 tons.

### **Cheese**

**MY2010**

Based on export data and industry reports, cheese production is down and is likely to continue trending downward. Reflecting this, the production estimate has been revised downward by 11.6% to 268,000 tons.

**MY2011**

Production is forecast to continue falling to 255,000 tons in MY2011. The forecast reflects the expectation that production decisions will favor WMP production and a tendency to use cheese plants to “mop up” peak milk flows from October to December. Cheddar for further processing makes up 67% to 73% of total cheese production. According to trade contacts, demand for this product is weak, particularly from South East Asia.

**Processors**

According to reports by KMPG, Westland Milk Products has announced plans to build a milk-concentrate plant at Rolleston, establishing a foothold in the Canterbury region of the South Island. Westland is already transporting milk from Canterbury to the West Coast as they are purchasing 50 million liters of DIRA milk from Fonterra. The plans include building a milk concentrator at the cooperative’s new Rolleston storage facility by 2012 and constructing a NZ \$100 million value-added product factory in 2013. Westland’s entry share price for new farmers is reportedly close to NZ \$1.50 per kilogram of milk solids, much lower than Fonterra’s NZ \$4.60. This could entice some of Canterbury’s dairy farmers to shift supply to Westland.

Fonterra will reportedly be building a new milk processing dryer in Southland by the end of the decade as its Edendale plant is forecast to reach capacity next season. The plant now has a capacity of 15.1 million liters a day, the biggest processing capacity of any site in the world. Fonterra reportedly also has plans to build another drier/processing plant in mid-Canterbury.

New Zealand: Overview of Dairy Processors (other than Fonterra)						
Company Name	Date Established	Company Type	Forecast Total Milk Processed 2010/11 Season 1/	Forecast Milk Accessed under DIRA 2010/11 Season	Estimated Milk Processed 2012/13 Season	Product Focus
			Millions of kilograms of milk solids			
North Island						
Tatua	1919	Cooperative	16.5	4.3	17.5	Caseinates, AMF, Specialty Products
Goodman Fielder		Corporate	24	24	24	Yogurt and Fluid Milk
Open Country Dairy	2007	Corporate	55	4.3	58	Cheese, Whey (low protein), WMP, SMP, AMF
NZ Dairy Processing Ltd	2010	Corporate	3	3	5	UHT liquid milk
Miraka Milk	construction nearing completion	Corp/Iwi	0	0	17	WMP/SMP AMF
Arapuni Milk Coy	Planning Capital Raising, Consents granted	Corporate	0	0	17	WMP
Dairyland	in planning stages	Corporate integrated farming & processing	0	0	0	WMP/SMP AMF
Estimated N.I.			98.5	35.6	138.5	
South Island						
Westland Milk Products	1937	Cooperative	52	4.3	54	Milk Powder, Butter, AMF, Caseins, Caseinates etc.
Open Country Dairy	2007	Corporate	23	0	42	Whey (low protein), WMP, SMP, AMF
NZ Dairies	2007	Corporate	18	3	18	WMP and Child Nutrition Products
Synlait	2008	Corporate	25	4.3	40	WMP, AMF, SMP, Enfant formula & Nutritional Products
Cadbury		Corporate	2.2	2.2	2.2	Confectionary
Mataura Valley Milk	In process of raising capital	Corporate	0	0	0	WMP
Oceania Milk	site purchased by Synlait	Corporate	0	0	0	WMP
Estimated S.I.			120.2	13.8	156.2	
Other Small Processors			3	3	3	Various, artisan cheeses etc
Total NZ			221.7	52.4	297.7	

Sources: Post, Fonterra, Westland, Tatua, MAF



## PSD Tables

Dairy, Milk, Fluid New Zealand	2009			2010			2011		
	Market Year Begin: Jan 2009			Market Year Begin: Jan 2010			Market Year Begin: Jan 2010		
1,000 Head 1,000 MT	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Cows In Milk	4597	4597	4597	4753	4753	4700	4850	4850	4800
Cows Milk	17397	17397	16983	16897	16897	17173	18642	18642	18049
Other Milk	0	0	0	0	0	0	0	0	0
Total Production	17397	17397	16983	16897	16897	17173	18642	18642	18049
Other Imports	2	2	2	2	2	2	2	2	2
Total Imports	2		2	2	2	2	2	2	2
Total Supply	17399	17399	16985	16899	16899	17175	18644	18644	18051
Other Exports	98	98	98	127	127	123	130	130	125
Total Exports	98	98	98	127	127	123	130	130	125
Fluid Use Dom	331	331	300	340	340	300	340	340	300
Factory Use Cons	16925	16925	16537	16387	16387	16702	18129	18129	17576
Feed Use Dom	45	45	50	45	45	50	45	45	50
Total Dom	17301	17301	16887	16772	16772	17052	18514	18514	17926
Total Distribution	17399	17399	16985	16899	16899	17175	18644	18644	18051
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0
TS=TD			0		0	0	0	0	0

Dairy, Dry Whole Milk Powder New Zealand  (1000 MT)	2009			2010			2011		
	Market Year Begin: Jan 2009			Market Year Begin: Jan 2010			Market Year Begin: Jan 2011		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	70	150	150	20	100	100	10	60	100
Production	768	768	768	850	830	947	900	900	1015
Other Imports	1	1	1	1	1	2	1	1	1
Total Imports	1	1	1	1	1	2	1	1	1
Total Supply	839	919	919	871	931	1049	911	961	1116
Other Exports	818	818	818	860	870	948	885	885	990
Total Exports	818	818	818	860	870	948	885	885	990
Human Dom. Cons.	1	1	1	1	1	1	1	1	1
Other Use, Losses	0	0	0	0			0	0	0
Total Dom. Cons.	1	1	1	1	1	1	1	1	1
Total Use	819	819	819	861	871	949	886	886	991
Ending Stocks	20	100	100	10	60	100	25	75	125
Total Distribution	839	919	919	871	931	1049	911	961	1116

CY Imp. from U.S.	0	0	0	0			0	0	0
CY. Exp. to U.S.	3	3	3	1	1	0	1	1	1
TS=TD		0	0		0	0		0	0

Dairy, Milk, Nonfat Dry New Zealand	2009			2010			2011		
	Market Year Begin: Jan 2009			Market Year Begin: Jan 2010			Market Year Begin: Jan 2011		
(1000 MT)	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	34	70	70	14	50	50	14	50	50
Production	385	385	385	355	355	344	400	400	375
Other Imports	4	4	4	2	2	3	2	2	3
Total Imports	4	4	4	2	2	3	2	2	3
Total Supply	423	459	459	371	407	397	416	452	428
Other Exports	408	408	408	355	355	344	400	400	375
Total Exports	408	408	408	355	355	344	400	400	375
Human Dom. Cons.	1	1	1	2	2	3	2	2	3
Other Use, Losses	0	0	0	0	0	0	0		
Total Dom. Cons.	1	1	1	2	2	3	2	2	3
Total Use	409	409	409	357	357	347	402	402	378
Ending Stocks	14	50	50	14	50	50	14	50	50
Total Distribution	423	459	459	371	407	397	416	452	428
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0
TS=TD			0		0	0		0	0

Dairy, Butter New Zealand	2009			2010			2011		
	Market Year Begin: Jan 2009			Market Year Begin: Jan 2010			Market Year Begin: Jan 2010		
(1000 MT)	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	70	80	80	46	56	56	30	40	50
Production	482	482	482	453	453	441	500	500	454
Other Imports	1	1	1	1	1	1	1	1	1
Total Imports	1	1	1	1	1	1	1	1	1
Total Supply	553	563	563	500	510	498	531	541	505
Other Exports	489	489	489	450	450	428	461	461	435
Total Exports	489	489	489	450	450	428	461	461	435

Domestic Cons.	18	18	18	20	20	20	20	20	20
Total Use	507	507	507	470	470	448	481	481	455
Ending Stocks	46	56	56	30	40	50	50	60	50
Total Distribution	553	563	563	500	510	498	531	541	505
CY Imp. from U.S.	0	0	0	0	0	0	0		
CY. Exp. to U.S.	37	37	37	35	35	22	35	35	25
TS=TD	0	0	0	0	0	0	0	0	0

Note 1: Non butter fat products such as AMF are brought up to a butter equivalency by multiplying by 1.22.

Dairy, Cheese New Zealand  (1000 MT)	2009			2010			2011		
	Market Year Begin: Jan 2009			Market Year Begin: Jan 2010			Market Year Begin: Jan 2011		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	41	55	55	41	55	55	41	55	40
Production	308	308	308	303	303	268	313	313	255
Other Imports	6	6	6	6	6	6	6	6	6
Total Imports	6	6	6	6	6	6	6	6	6
Total Supply	355	369	369	350	364	329	360	374	301
Other Exports	290	290	290	285	285	265	295	295	237
Total Exports	290	290	290	285	285	265	295	295	237
Human Dom. Cons.	24	24	24	24	24	24	24	24	24
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	24	24	24	24	24	24	24	24	24
Total Use	314	314	314	309	309	289	319	319	261
Ending Stocks	41	55	55	41	55	40	41	55	40
Total Distribution	355	369	369	350	364	329	360	374	301
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	17	17	17	7	7	5	0	10	7
TS=TD		0	0		0	0	0	0	0

Note 2: these tables are not official USD forecasts.

## Consumption

The 2010 milk consumption estimate has been revised downward by 11% to 300,000 tons and is forecast to remain at this level in 2011. The downward revision is largely due to a drop in demand stemming from domestic price increases. According to Statistics New Zealand, food prices as of March 2011 were up 5.5% compared to a year earlier. Fresh milk prices were up 9.3%, beef prices 8.2%, and lamb prices 16.4%. During March 2011, the price of fresh milk fell slightly, down 0.2%, possibly as a result of an announcement by supermarket chains in February that prices would not increase for the rest of the year. The announcement followed Fonterra's decision to freeze its wholesale domestic milk price to distributors and retailers. Fonterra's profit margin on a two-liter bottle of milk is reportedly 12%. The two large supermarket changes, Foodstuffs and Progressive Enterprises, have not revealed their profit margins.

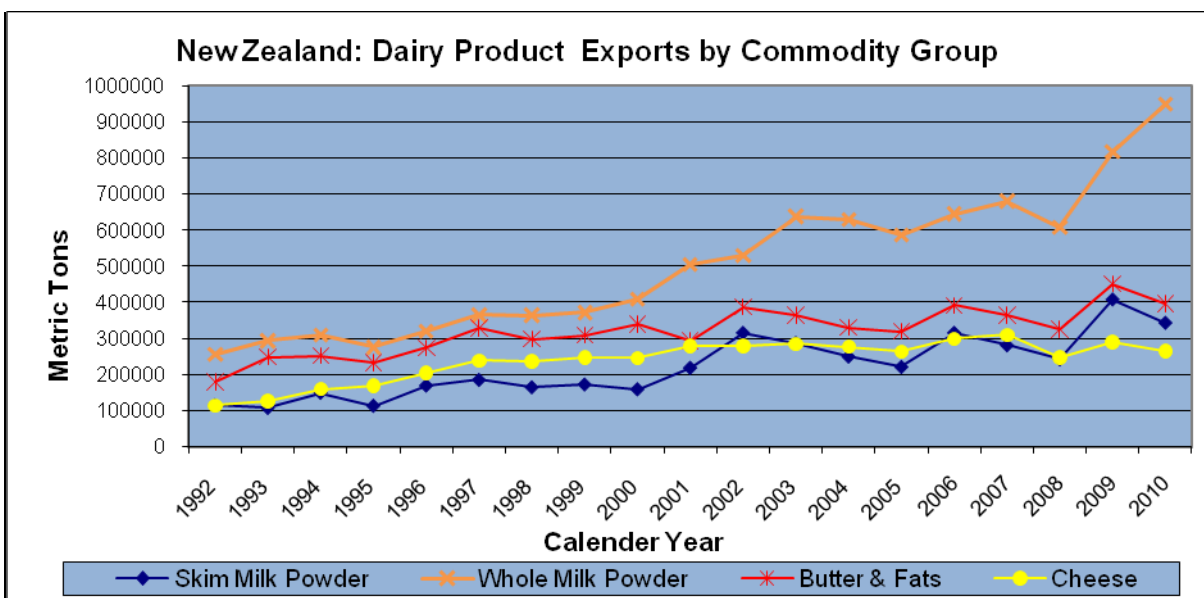
The rise in milk prices has sparked public concern and the Commerce Commission is investigating whether a full milk price inquiry is needed. At a recent commerce select committee meeting in Parliament, Consumer NZ alleged that the current regulatory regime has failed to ensure contestability in the raw milk market. The consumer organization supports a call for an independent milk price regulator. Fonterra is strongly opposed to the notion of introducing an independent price regulator, saying it would jeopardize New Zealand's reputation with trading partners and reverse its free market trading policy.

## Trade

### Exports

Total 2010 exports fell slightly (1.5%) to 2.3 million tons. (Although 2009 exports were boosted by stock levels held over from 2008.) Exports in 2011 are forecast to hit a record high in the region of 2.35 million to 2.4 million tons depending on ending stock levels and spring pasture growth.

According to press reports, Fonterra hit an all time record during the month of March 2011 with exports reaching 229,000 tons. Recent warm weather coupled with demand from China, South East Asia and the Middle East has driven the record result. *(Note: liquid products adjusted to product weight equivalent, but AMF not adjusted as per PSD tables.)*



Source: Global Trade Atlas (GTA)

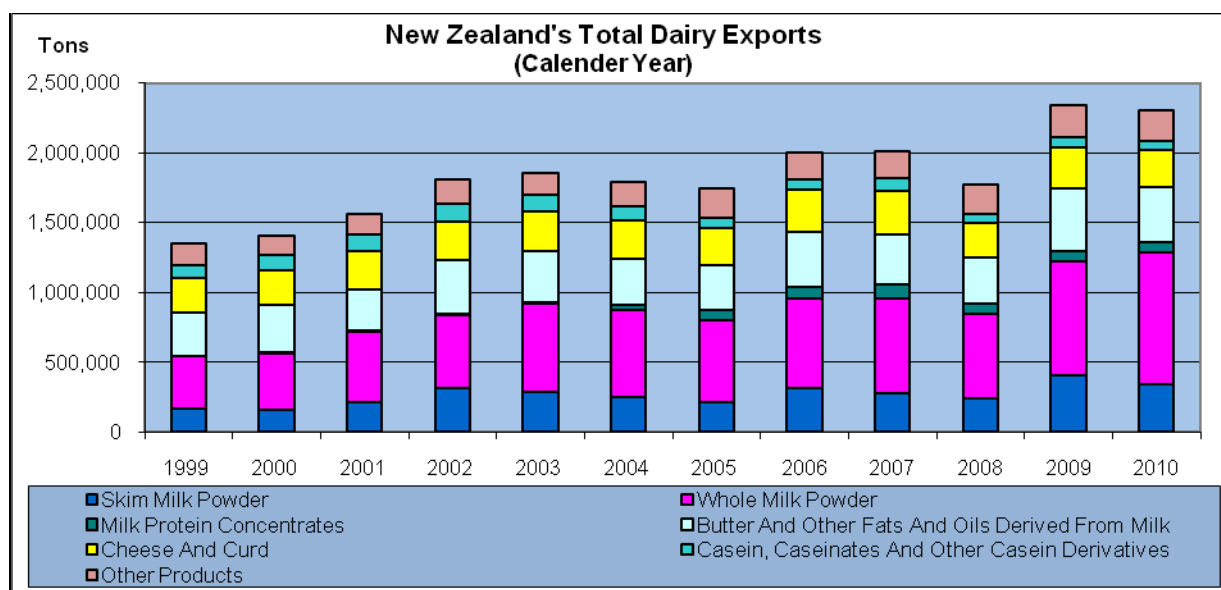
### Whole Milk Powder (WMP)

#### MY2010

WMP exports in MY 2010 were 9% higher than forecasted reaching 948,000 tons. This is a 16% increase from MY 2009.

#### MY2011

WMP exports are forecast to increase further to 990,000 tons, which is 11.9% higher than previously forecasted. Industry contacts suggest that, given the supply and demand situation, WMP exports will increase at the expense of cheese exports. During the first two months of CY 2011, WMP exports were already 55,000 tons ahead of the previous year.



Source: Global Trade Atlas (GTA), Post

## Butter and Other Fats

### MY2010

Actual butter (AMF is adjusted to a butter equivalent) exports were 428,000 tons, down 4.9% from the previous forecast.

### MY2011

Butter exports are forecast to increase to 435,000 tons but will be down on previous forecast by 5.6%. Although there are some indications that relative pricing still favors production of AMF/SMP, there are other factors that suggestion additional milk supply will go toward the production of WMP.

## Skim Milk Powder

### MY2010

SMP exports were 344,000 tons, 11,000 tons or 3% less than the previous estimate.

### MY2011

SMP exports are forecast to increase in MY2011 to 375,000 tons. However, this is a 6.25% downward revision compared to the initial forecast.

## Cheese

### MY2010

Cheese exports fell to 265,000 tons, which is 7% down from the previous estimate. According to industry contracts, prevailing prices don't warrant additional production, especially for ingredient grade cheddar which makes up 67% to 73% of total cheese exports.

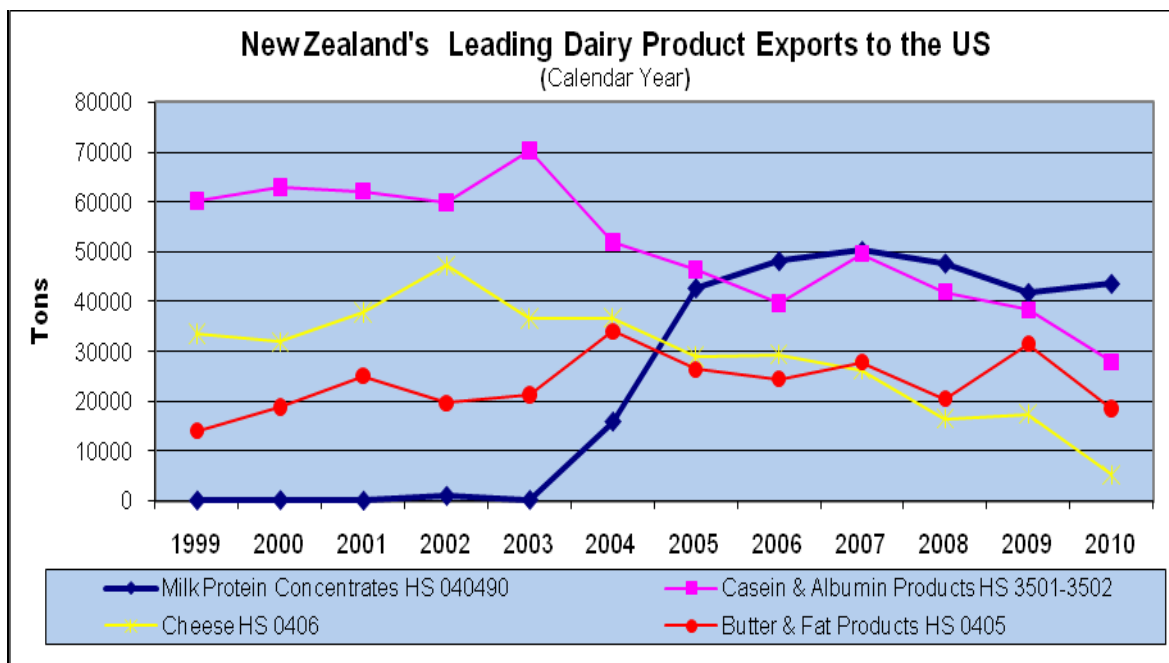
### MY2011

Exports are forecast to fall further to 237,000 tons. This is a 19.7% less than the original forecast and largely due to relative pricing of commodities.

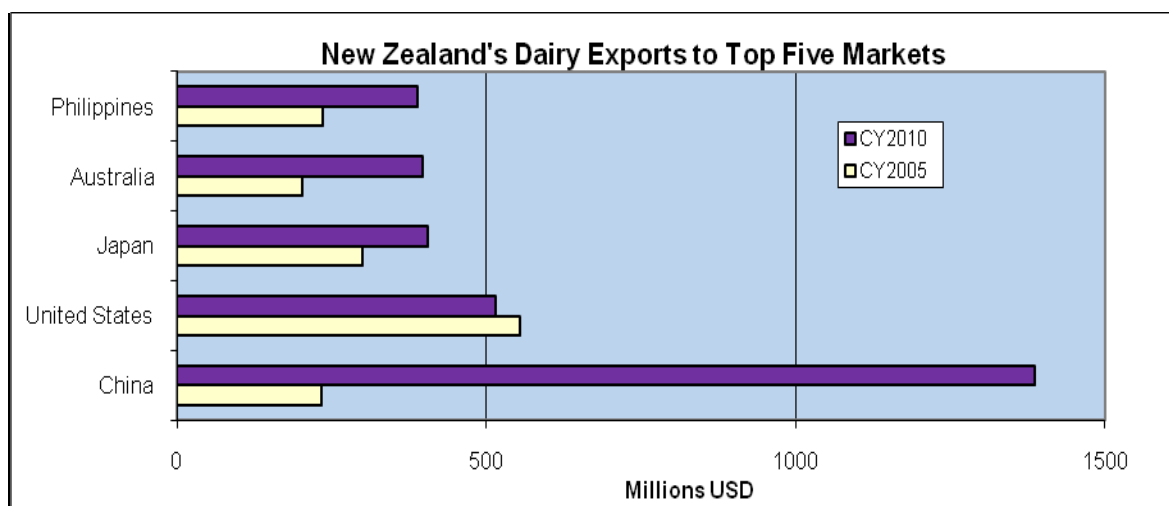
## United States

New Zealand exported just over 96,000 tons of dairy products to the United States in 2010, valued at US \$515 million, which is 5% less than the previous year and well below the peak of US \$706 million in 2008. Total tonnage was down 37,000 tons when compared to 2009.

Major exports to the US market include: milk protein concentrates, butter and fat products, and casein. Cheese exports dropped to 5,291 tons, down from 17,465 tons in 2009 and a peak of 47,253 tons in 2002. The predominant type of cheese exported by New Zealand is bulk cheddar for further processing. The relative profitability for this product has trended downward over the last few years.



Source: GTA



Source: GTA

New Zealand: Dairy Products to Top Five Markets						
(CY2010/metric tons)						
	China	USA	Japan	Australia	Philippines	World Total
Liquid Milk (T)	8,168	120	0	11,085	39,463	123,446
SMP	50,790	203	4,851	5,345	41,904	343,371
WMP	294,181	328	0	7,492	22,332	948,473
Consumer Products	2,987	60	4,082	3,370	12,355	49,710
MPC	1,383	43,654	2,866	1,490	1,449	73,279
Butter & Fats	19,351	18,502	731	16,587	14,945	395,338
Cheese	11,702	5,291	53,346	54,290	10,866	264,819
Casein	4,872	22,999	10,045	768	819	61,593
Whey Products	7,806	5,179	4,887	2,583	130	27,890
Other Products incl Lactose	328	103	4,147	1,460	460	18,896
Total Volume	401,568	96,439	84,955	104,470	144,723	2,306,815
Total Value in 1000's USD	\$1,386,864	\$514,623	\$404,798	\$396,888	\$389,398	\$8,144,846
Price per Metric Ton in USD	\$3,454	\$5,336	\$4,765	\$3,799	\$2,691	\$3,531

Source: GTA

## Global Dairy Trade – the Fonterra Commodity Auction Platform

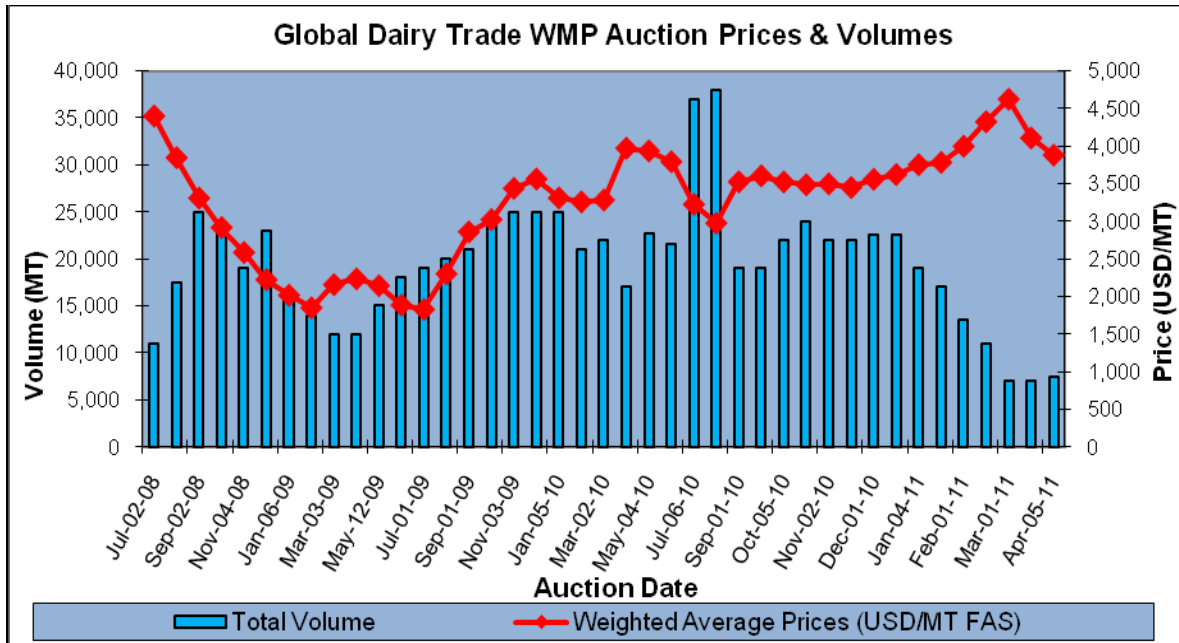
In 2010, 544,150 tons of products were sold through Global Dairy Trade (gDT), which equates to 23.6% of total exports. This compares to 228,700 tons in 2009, which accounted for 9.8% of exports.

WMP, SMP, and AMF make up the bulk of commodities sold on the platform but butter milk powder and industrial butter are also being sold. As of May 2011, milk protein concentrate and rennet casein will be offered. Industrial cheddar cheese will be added in July 2011.

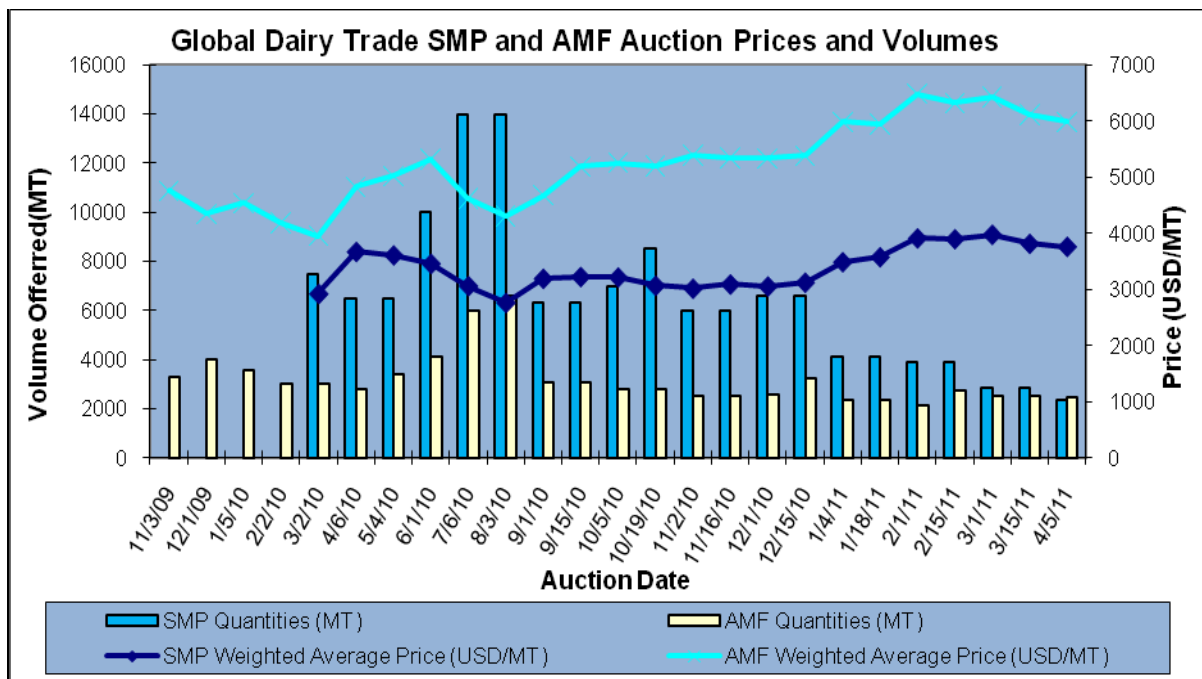
Fonterra has publically stated that it would like other vendors to join the platform. In March 2011, Fonterra published draft rules that would govern the opening of the online auction to other companies. The rules were reportedly developed with input from other global dairy firms including Arla Foods, FrieslandCampina, DairyAmerica and Australia's Murray Goulburn.

According to media reports, California Dairies Inc. (CDI) is expected to start selling SMP on the gDT platform perhaps later in 2011 or early in 2012. CDI is second largest dairy co-operative in the US and the largest supplier of milk powder to DairyAmerica.





Source: Global Dairy Trade



Source: Global Dairy Trade

## **Policy**

### **Third Stage of Fonterra Capital Restructuring - Trading Among Farmers (TAF)**

In order for Fonterra to implement the final phase of its capital restructuring plan, the New Zealand Government must make legislative changes to the Dairy Industry Restructuring Act (DIRA). The revision to DIRA would enable Fonterra to implement a scheme known as “Trade Amongst Farmers” (TAF). Fonterra needs permanent capital to pursue its overseas growth ambitions and wants to rid itself of the statutory obligation to redeem shares when farmers exit the cooperative or reduce milk supply. TAF would require farmers exiting the cooperative to find buyers for their shares rather than relying on Fonterra to redeem them. There was overwhelming support among Fonterra shareholders for TAF, with the 79% of those who voted being 90% in favor. However, Fonterra competitors have expressed concern that introduction of share trading will lock farmers into Fonterra, thereby diminishing market competition for farmers’ milk.

While it was initially expected that TAF could be in place by November 2011, some speculate that election year hurdles - a Commerce Commission investigation into the retail price of milk, reported uneasiness in the investment community about some aspects of the proposal, and a tight legislative timetable – could throw up roadblocks delaying the implementation of TAF till sometime in 2012.

According to press reports, Agriculture Minister David Carter has all but ruled out Fonterra’s chances of getting legislation changed prior to the November election, and there could be further delays if the Commerce Commission decides to go ahead with an inquiry into milk pricing. Such an inquiry could also affect the timing of a current government review of the 2001 raw milk regulations which require Fonterra to sell a fixed quantity of raw milk annually to its competitors.

The Ministry of Agriculture and Forestry (MAF) published a discussion document in February 2011 on Fonterra’s proposal. (Click on the following link to read the document: <http://www.maf.govt.nz/news-resources/consultations/dairy-industry-restructuring-act-proposals-to-permi.aspx>) The document attracted 23 public submissions, of which, seven fully supported TAF; seven supported the idea and goals behind TAF but had reservations regarding the means by which Fonterra was going about achieving its goals and how that would affect other industry stakeholders; and nine were opposed to the proposal. Key concerns included the potential for insufficient liquidity in the TAF market and milk price setting. Several respondents requested full disclosure regarding how the milk price is calculated.

### **Commerce Commission Considers Milk Price Inquiry**

Rising retail milk prices have led the industry and public to call for an independent regulator of domestic milk prices. The New Zealand Commerce Commission has announced that it will conduct a preliminary investigation into the domestic milk market to determine if a full price inquiry is warranted. Its report is expected within the next few months.

### **Dairy Industry Restructuring Act (DIRA) – Bill to Extend Sunset Clauses**

The competition policy measures in DIRA are subject to sunset clauses based on the proportion of milk collected by independent processors. According to MAF, some of these triggers could be met as early

as 2012. The phase-out of these triggers spells the end of Fonterra's obligation to supply raw milk at regulated prices. The rationale behind the raw milk regulations is to protect consumers from monopoly pricing and to provide an entrance pathway for new processors (by helping to ensure access to an adequate milk supply). A bill was introduced into parliament that keeps the raw milk regulations in place until Fonterra's share of milk production falls to 80% (revised downward from 87.5%) at which time an additional review will be completed.

## **Free Trade Agreements**

The following agreements are in force:

- [New Zealand-Hong Kong, China Closer Economic Partnership](#) (NZ-HK CEP entered into force on 1 January 2011)
- [New Zealand-Malaysia Free Trade Agreement](#) (MNZFTA entered into force on 1 August 2010)
- [ASEAN-Australia-New Zealand Free Trade Agreement](#) (AANZFTA) - 2010
- [New Zealand-China Free Trade Agreement](#) (NZ-China FTA) - 2008
- [Trans-Pacific Strategic Economic Partnership](#) (P4) - 2005
- [New Zealand-Thailand Closer Economic Partnership](#) (NZTCEP) - 2005
- [New Zealand-Singapore Closer Economic Partnership](#) (NZSCEP) - 2001
- [Australia-New Zealand Closer Economic Relationship](#) (CER) - 1983

In addition, the New Zealand Government is currently negotiating the following FTAs:

- [New Zealand-Gulf Cooperation Council Free Trade Agreement](#) (NZ-GCC FTA negotiations have been concluded but not yet signed)
- Expansion of the [Trans-Pacific Strategic Economic Partnership](#) (TPP)
- [New Zealand-Korea Free Trade Agreement](#) (NZ-Korea FTA)
- [New Zealand-India Free Trade Agreement](#) (NZ-India FTA)
- [New Zealand-Russia-Belarus-Kazakhstan Free Trade Agreement](#) (NZ-RBK)

While exporters report that FTAs do not drive business decisions, they do provide a framework to work out trade-related issues, especially SPS and non-tariff barriers, and, in some cases, convey significant market access advantages. For instance, in the New Zealand -China FTA, tariffs on milk powder will be reduced from 10% to 3.3% by 2015. By 2015, the tariff savings will be US \$268/ton, which, at current WMP prices of US \$4,000/ton, equates to 7%.

## **Sustainability Developments – Clean Streams Accord**

The Dairying and Clean Streams Accord remains a key environmental initiative alongside many other projects and strategies that support and improve the dairy industry's social, economic and environmental performance. The Dairying and Clean Streams Accord is an agreement between the Ministry of

Agriculture and Forestry (MAF), Ministry for the Environment, Fonterra and Local Government New Zealand (on behalf of regional councils). Signed in May 2003, the Accord provides a framework for these organizations to work together on environmental matters. Farmers who don't supply Fonterra are not part of the accord.

### Regional Dairy Effluent Compliance Results for the 2007/08–2009/10 Seasons

Regional council	Full compliance %			Non-compliance %			Significant non-compliance (%)			Total Fonterra Farms	Total Farms Assessed
	2008	2009	2010	2008	2009	2010	2008	2009	2010	2010	2010
Northland	43	39	43	31	34	33	26	27	24	927	947
Auckland	73	45	62	19	32	32	7	23	6	317	310
Waikato	48	41	52	42	39	21	10	20	27	3749	686
Bay of Plenty	76	73	79	15	18	11	9	9	10	650	364
Taranaki	96	96	96	4	3	3	0.2	0.5	1	1687	1782
Hawke's Bay	74	83	62	16	13	33	11	5	4	85	78
Horizons	78	77	81	0	9	4	22	14	15	830	384
Wellington	53	72	89	19	24	9	28	4	1	180	177
Tasman	93	89	73	5	6	19	2	5	8	138	37
Marlborough	75	88	57	25	10	38	0	2	5	61	60
Canterbury	46	43	59	34	37	33	20	19	8	803	769
Otago	83	75	95	10	20	4	8	5	2	342	389
Southland	65	69	39	22	18	48	13	13	13	758	768
Weighted Average(a)	64	60	65	25	26	20	12	15	16	10527	6751

Source: MAF, Fonterra

### Land and Water Forum

In June 2009, the New Zealand Government announced a new water management program called the New Start for Fresh Water Program. The program is expected to establish a fairer and more efficient water management system. The Land and Water Forum is one of the initiatives under the program. The Forum released a report in September 2010 that sets out a framework for moving water management forward, which would potentially be beneficial to the dairy sector and support further expansion. *Report of the Land and Water Forum: A Fresh Start for Fresh Water;*  
[www.landandwater.org.nz](http://www.landandwater.org.nz)